

UT 06-4

Tax Type: Use Tax

Issue: Rolling Stock (Vehicle Used Interstate For Hire)

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
SPRINGFIELD, ILLINOIS**

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THE DEPARTMENT OF REVENUE	)	
OF THE STATE OF ILLINOIS	)	
	)	<b>Docket # 00-ST-0000</b>
v.	)	<b>IBT # 0000-0000</b>
	)	<b>NTL # 00-00000000000000</b>
ABC, LLC d/b/a XYZ, INC.	)	
	)	
Taxpayer	)	

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**RECOMMENDATION FOR DISPOSITION**

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Kathy R. Chamberlain of Howard, Habecker & Morris, LLC for ABC, LLC d/b/a XYZ, Inc..

Synopsis:

The Department of Revenue (“Department”) conducted an office audit concerning the purchase of an aircraft by ABC, LLC d/b/a XYZ, Inc. (“taxpayer”). The aircraft was purchased in September 2000, and the audit period was from the date of purchase through March 2002. After the audit, the Department issued a Notice of Tax Liability (“NTL”) to the taxpayer for use tax, penalty, and interest on the purchase of the plane. The taxpayer timely protested the NTL, and an evidentiary hearing was held. The taxpayer contends that the aircraft is exempt from use tax on the basis that it is used as rolling stock in

interstate commerce for hire. After reviewing the record, it is recommended that this matter be resolved in favor of the taxpayer.

FINDINGS OF FACT:

1. On September 22, 2000, the taxpayer purchased a 1981 Beechcraft King Air B200 from Aircraft Sales, Inc. (Taxpayer Ex. #2, 4; Tr. p. 54)

2. Between September 2000 and December 2000, the paint and the interior of the plane were refurbished. (Taxpayer Ex. #5, 6; Tr. pp. 56-57)

3. On January 2, 2001, the engines were removed from the plane in order to be overhauled. The taxpayer expected the engines to be overhauled within 45 days, but it took six months due to a misunderstanding concerning the cost of the overhaul. (Taxpayer Ex. #7, 8; Tr. pp. 57-59)

4. The aircraft met all the requirements of its compliance inspection on July 2, 2001. (Taxpayer Ex. #11; Tr. pp. 61-62)

5. The taxpayer, as the lessor, entered into an Aircraft Lease Agreement for a term of one year with MMM Aviation, Inc. (“MMM”) concerning the taxpayer’s aircraft. The agreement provides that the aircraft shall be permanently based at Peoria, Illinois, and states as follows: “Lessor agrees that Lessee is leasing the Aircraft for the purpose of: a. Charter (Air Taxi under FAR Part 135).” (Taxpayer Ex. #10; Tr. p. 55)

6. The lease also provides that “Pilot service will be provided by Lessor to Lessee for the term of this agreement. \* \* \* Lessor recognizes and Lessee warrants and agrees that this aircraft utilized by Lessee in its air taxi business must meet the requirements of Part 135 of the Federal Aviation Regulations.” (Taxpayer Ex. #10)

7. The lease provides that “Lessor’s personnel operating under the Lessee’s 135 Air Carrier Certificate shall be directly responsible to Lessee’s Director of 135 operations or his/her designee. Any flight conducted by Lessor’s personnel under the Lessee’s 135 Air Carrier Certificate shall be conducted in accordance with all applicable Federal Aviation Regulations and Lessee’s Operations Specifications and Operations Manual.” (Taxpayer’s Ex. #10)

8. The Department received a copy of the registration application for the aircraft from the Department of Transportation and determined that a use tax return had not been filed for the plane. In April 2002, the Department began an office audit concerning the purchase of the aircraft and used the time period from the date of purchase to March 31, 2002 as the audit period. (Tr. pp. 8-9, 16-17)

9. During the hearing the taxpayer provided copies of the flight logs and corresponding invoices for the aircraft for the audit period. The taxpayer had used this information to prepare summary documents indicating the date of the flight, the destination, the client, and the number of hours flown. (Dept. Ex. #6, Taxpayer Ex. #12, 13, 17)

10. In addition to presenting summaries for the audit period, the taxpayer presented summaries for the remaining months of 2002, 2003, and the first six months of 2004. The Department agreed that the summaries accurately reflect the supporting documents. (Taxpayer Ex. #14-16; Tr. p. 106)

11. From June 28, 2001 through December 31, 2001, the aircraft was used for a total of 27 flights and 81.2 hours. Six of the flights were for training and maintenance purposes for a total of 5.1 hours. Eleven of the flights were for XXX Technology

Services (“XXX”): ten of these flights were interstate for a total of 52.5 hours, and one flight was intrastate for .6 hours. Of the remaining ten flights, five were interstate for various customers for 15.7 hours, and five were intrastate for similar customers for 7.3 hours.<sup>1</sup> (Taxpayer Ex. #12, 16)

12. Of the five interstate flights during 2001 that were not for XXX, the invoices show that four of the customers paid a significant amount for the services. The invoice for one of the flights (#210) shows an amount charged of \$1. (Dept. Ex. #6)

13. During the first quarter of 2002, the aircraft was used for a total of 26 trips and 51.7 hours. One trip was for training purposes for .6 hours. Of the remaining 25 trips, 10 were interstate for various customers for 28.6 hours, and 15 were intrastate for similar customers for 22.5 hours.<sup>2</sup> (Taxpayer Ex. #13, 16)

14. Of the 10 interstate flights during the first quarter of 2002, the invoices indicate that each customer paid a significant amount for the use of the aircraft. (Taxpayer Ex. #17)

15. On April 29, 2004, the Department prepared a corrected return for the taxpayer that assessed use tax, penalties, and interest on the purchase of the aircraft. The corrected return was admitted into evidence under the certification of the Director of the Department. (Dept. Ex. #3)

#### CONCLUSIONS OF LAW:

The Use Tax Act (35 ILCS 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the Use Tax Act incorporates by reference section 4 of the Retailers'

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<sup>1</sup> The interstate customers were XXX, Inc., XXXXXXXX, Inc., and XXX Manufacturing. (Taxpayer Ex. #12, 19, Dept. Ex. #6)

<sup>2</sup> The interstate customers were XXXXX, XXXXX, XXXXX, and XXXXXX. (Taxpayer Ex. #13, 17)

Occupation Tax Act (35 ILCS 120/1 *et seq.*), which provides that the corrected return issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due, as shown therein. 35 ILCS 105/12; 120/4. Once the Department has established its *prima facie* case by submitting the corrected return into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1<sup>st</sup> Dist. 1987). To prove its case, a taxpayer must present more than its testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4<sup>th</sup> Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim for an exemption. *Id.*

It is well-settled that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). The party claiming the exemption has the burden of clearly proving that it is entitled to the exemption, and all doubts are resolved in favor of taxation. *Id.*

The rolling stock exemption under the Use Tax Act provides in relevant part as follows:

"Multistate exemption. To prevent actual or likely multistate taxation, the tax imposed by this Act does not apply to the use of tangible personal property in this State under the following circumstances:

\* \* \*

(b) The use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock moving in interstate commerce or by lessors under a lease of one year or longer executed or in effect at the time of purchase of tangible personal property by interstate carriers for-hire for use as rolling stock moving in interstate commerce as long as so used by the interstate carriers for-hire \*\*\*" (35 ILCS 105/3-55(b)).

The term "rolling stock" includes aircrafts. See 86 Ill. Admin. Code, ch. 1, §130.340(b).

Thus, if the taxpayer is a lessor, in order to qualify for the exemption the taxpayer must establish that (1) the aircraft is under a lease of one year or longer; (2) the aircraft was used by an interstate carrier for hire and (3) the aircraft in question moved in interstate

commerce. In order to prove that the aircraft moved in interstate commerce, the taxpayer must show that its interstate use was regular and frequent or more than merely incidental. National School Bus Service, Inc. v. Department of Revenue, 302 Ill. App. 3rd 820 (1<sup>st</sup> Dist. 1998).

The Department argues that although the taxpayer provided information concerning flights after the audit period, the audit period was reasonable and should not be extended. The Department also argues that during the audit period, the taxpayer rented the aircraft to XXX, and the flights taken during this rental period should not be considered “for hire” flights. The Department claims that most of the remaining flights were not interstate flights for hire, and the taxpayer has not established that the aircraft qualifies for the exemption.

The taxpayer claims that whether the focus is only on the audit period or also includes the subsequent time period, it presented sufficient evidence to show that the aircraft was used in interstate commerce for hire. The taxpayer argues that the “rental” to XXX was not the typical rental agreement because the aircraft was not given to XXX for its use. The taxpayer contends that the agreement with XXX only gave XXX first priority for the use of the plane during a short time period. According to the taxpayer, its pilots continued to fly the plane and maintained control of all the flights for XXX, and all of the interstate flights for XXX should be considered for hire flights. For the remaining flights, the taxpayer asserts that although it might not have made its case clear at the audit level, the invoices show that these flights were interstate trips for hire and were enough to qualify the aircraft for the exemption.

The auditor explained that he started his audit inquiry in April 2002, so he chose the audit period to be from the date of purchase through March 31, 2002. In Chicago & Illinois Midland Railway Company v. Department of Revenue, 66 Ill. App. 3d 397 (1<sup>st</sup> Dist. 1978), the court rejected the taxpayer's argument that the auditor improperly restricted his inquiry concerning the rolling stock exemption to the audit period. The court noted that some period had to be chosen in order to be able to administer the Act, and it was appropriate for the auditor to limit his attention to the audit period. In the present case, although the audit period is approximately 18 months, the plane was being refurbished during the first 9 months after it was purchased. Only 9 months of flight activity remain for determining whether the plane qualifies for the exemption. Although this may seem like a relatively small period of time, it is enough time to determine whether the interstate use of the aircraft was regular and frequent. According to the court in Chicago & Illinois Midland Railway, it is appropriate to limit the inquiry to this time period.

With respect to the allegations concerning XXX, the taxpayer did not present sufficient evidence to support its claims. The evidence includes the invoice to XXX for "rental" of the plane from August 30, 2001 to October 2, 2001. (Dept. Ex. #6, p. 12) Although the taxpayer contends that this was not a typical rental agreement, the taxpayer did not provide a copy of the agreement that it had with XXX concerning the use of the aircraft. Without the agreement or other substantiating evidence supporting the allegations concerning the agreement, it cannot be found that these interstate flights were for hire.

Nevertheless, even without considering the flights for XXX, the taxpayer presented enough evidence to show that the aircraft qualifies for the exemption. The flight logs and corresponding invoices show that the aircraft is used as an air taxi service on a for hire basis. Once the plane became operational, it was used 14 times for qualifying interstate trips during the 9 remaining months of the audit period.<sup>3</sup> The Department's regulation concerning rolling stock states that from August 14, 1999 through June 30, 2003, motor vehicles as defined in section 1-146 of the Illinois Vehicle Code qualify if they carry persons or property for hire in interstate commerce on 15 or more occasions in a 12-month period.<sup>4</sup> See 86 Ill. Admin. Code, ch. 1, §130.340(e). Although the regulation indicates that this test applies to motor vehicles and does not specifically state that it applies to aircraft, it is an indication as to what the Department considered to be regular and frequent during that time period.<sup>5</sup> In the present case, the use of the aircraft for hire in interstate commerce 14 times during the 9-month period was sufficient to qualify for the exemption.

Recommendation:

For the foregoing reasons, it is recommended that the aircraft qualifies for the rolling stock exemption.

Linda Olivero  
Administrative Law Judge

Enter: April 11, 2006

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<sup>3</sup> The one interstate trip during 2001 for which the invoice shows \$1 cannot be considered a "for hire" flight. The qualifying trips include the remaining four trips in 2001 and the ten trips during the first quarter of 2002.

<sup>4</sup> Motor vehicles as defined in section 1-146 of the Illinois Vehicle Code include vehicles that are self-propelled. (625 ILCS 5/1-146). Vehicles are defined in section 1-217 of the Code and include devices that are used upon a highway. (625 ILCS 5/1-217).

<sup>5</sup> After July 1, 2003, the test requires 51% of the trips during a 12 month period to be qualifying trips. 86 Ill. Admin. Code, ch. 1, §130.340(g).